



Unaudited Interim Consolidated Financial Statements and Footnotes

April 3, 2011

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<u>ASSETS</u>	<u>(Unaudited)</u> <u>Apr 3, 2011</u>	<u>Jan 2, 2011</u>
Current assets:		
Cash	\$ 512,597	\$ 319,449
Royalties receivable	120,122	101,800
Other receivables, net	578,829	457,933
Inventory	556,240	538,636
Prepaid expenses and other current assets	799,859	938,310
Assets related to discontinued operations, net	<u>100,000</u>	<u>100,000</u>
Total current assets	<u>2,667,647</u>	<u>2,456,128</u>
Property and equipment, net	14,386,165	14,921,126
Deferred tax assets	4,051,361	3,899,704
Other assets	178,937	162,770
Other assets related to discontinued operations	<u>33,878</u>	<u>33,878</u>
Total Assets	<u>\$21,317,988</u>	<u>\$21,473,606</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Current liabilities:		
Accounts payable	\$2,562,547	\$2,388,605
Accrued sales, liquor and payroll taxes	961,497	803,735
Accrued expenses	665,578	990,640
Income taxes payable	151,176	102,803
Current liabilities related to discontinued operations	--	3,180
Current portion of liabilities associated with leasing and exit activities	<u>199,581</u>	<u>222,914</u>
Total current liabilities	<u>4,540,379</u>	<u>4,511,877</u>
Long-term debt	4,400,000	4,400,000
Liabilities associated with leasing and exit activities, net of current portion	202,359	247,671
Deferred gain	468,322	520,357
Other liabilities	<u>1,911,045</u>	<u>1,951,799</u>
Total liabilities	11,522,105	11,631,704
Commitments and Contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value, 1,000,000 shares authorized, none issued	--	--
Common stock, \$0.01 par value, 20,000,000 shares authorized, 4,732,705 shares issued, 3,413,099 and 3,413,099 shares outstanding at 4/3/2011 and 1/2/2011, respectively	47,327	47,327
Additional paid-in capital	18,760,820	18,716,827
Retained earnings	2,681,203	2,771,215
Treasury stock at cost, 1,319,606 and 1,319,606 common shares, at 4/3/2011 and 1/2/2011, respectively	<u>(11,693,467)</u>	<u>(11,693,467)</u>
Total stockholders' equity	<u>9,795,883</u>	<u>9,841,902</u>
Total Liabilities and Stockholders' Equity	<u>\$21,317,988</u>	<u>\$21,473,606</u>

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
For the first quarter ended April 3, 2011 and April 4, 2010

	<u>Apr 3, 2011</u>	<u>Apr 4, 2010</u>
Revenues:		
Restaurant sales	\$16,797,787	\$16,853,074
Franchise fees, royalties and other	<u>121,586</u>	<u>123,912</u>
	<u>\$16,919,373</u>	<u>\$16,976,986</u>
Costs and expenses:		
Cost of sales	4,931,045	4,944,913
Labor	5,793,690	5,817,086
Restaurant operating expenses	3,999,765	4,384,888
General and administrative	1,492,996	1,448,500
Depreciation and amortization	804,635	858,366
Restaurant closure costs	--	5,221
Loss on sale of property and equipment	<u>15,263</u>	<u>3,715</u>
	<u>17,037,394</u>	<u>17,462,689</u>
Operating loss	<u>(118,021)</u>	<u>(485,703)</u>
Other income (expense):		
Interest income	528	11,783
Interest expense	(65,396)	(61,769)
Other, net	<u>(967)</u>	<u>18,568</u>
	<u>(65,835)</u>	<u>(31,418)</u>
Loss from continuing operations before income taxes	(183,856)	(517,121)
Income tax benefit	<u>93,844</u>	<u>221,690</u>
Loss from continuing operations	(90,012)	(295,431)
Discontinued operations:		
Restaurant closure costs	--	<u>(181,543)</u>
Loss from discontinued operations before income taxes	--	<u>(181,543)</u>
Income tax benefit	<u>--</u>	<u>77,827</u>
Loss from discontinued operations	<u>--</u>	<u>(103,716)</u>
Net loss	<u>\$(90,012)</u>	<u>\$(399,147)</u>

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)
For the first quarter ended April 3, 2011

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balances at January 2, 2011	\$47,327	\$18,716,827	\$2,771,215	\$(11,693,467)	\$9,841,902
Stock based compensation expense	--	43,993	--	--	43,993
Net loss	<u> --</u>	<u> --</u>	<u>(90,012)</u>	<u> --</u>	<u>(90,012)</u>
Balances at April 3, 2011	<u>47,327</u>	<u>18,760,820</u>	<u>2,681,203</u>	<u>(11,693,467)</u>	<u>9,795,883</u>

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
For the quarters ended April 3, 2011 and April 4, 2010

	<u>Apr 3, 2011</u>	<u>Apr 4, 2010</u>
Cash flows from operating activities:		
Net loss	\$ (90,012)	\$ (399,147)
Income from discontinued operations	<u>--</u>	<u>103,716</u>
Loss from continuing operations	(90,012)	(295,431)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	804,635	858,366
Deferred gain amortization	(52,035)	(52,035)
Restaurant closure costs	--	5,221
Other non-cash income	--	(16,454)
Loss on sale of property and equipment	15,263	3,715
Stock based compensation expense	43,993	44,919
Deferred income tax expense (benefit)	(151,657)	(359,786)
Changes in operating assets and liabilities		
Royalties receivable	(18,322)	(35,160)
Other receivables	(120,896)	66,022
Inventory	(17,604)	(22,284)
Income taxes receivable/payable	48,373	146,332
Prepaid and other current assets	138,451	266,414
Other assets	(16,167)	2,192
Accounts payable	173,942	674,105
Accrued expenses and other liabilities	(167,300)	(408,936)
Liabilities associated with leasing and exit activities	(68,645)	(44,166)
Deferred rent and other long-term liabilities	<u>(40,754)</u>	<u>11,924</u>
Total adjustments	<u>571,277</u>	<u>1,140,389</u>
Net cash provided by continuing operations	<u>481,265</u>	<u>844,958</u>
Net cash provided by (used in) discontinued operations	<u>(3,180)</u>	<u>(44,302)</u>
Net cash provided by operating activities	478,085	800,656
Cash flows from investing activities:		
Purchase of property and equipment	(288,808)	(511,525)
Proceeds from sale of property and equipment	<u>3,871</u>	<u>7,024</u>
Net cash used in investing activities	<u>(284,937)</u>	<u>(504,501)</u>
Cash flows from financing activities:		
Borrowings under line of credit agreement	--	650,000
Payments under line of credit agreement	--	(1,250,000)
Issuance of treasury stock	<u>--</u>	<u>277,972</u>
Net cash used in financing activities	<u>--</u>	<u>(322,028)</u>
Net increase (decrease) in cash	193,148	(25,873)
Cash at beginning of year	<u>319,449</u>	<u>719,944</u>
Cash at end of year	<u>\$ 512,597</u>	<u>\$ 694,071</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year:		
Interest	\$ 64,059	\$ 59,042
Income taxes	\$ 20,000	--

MEXICAN RESTAURANTS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of presentation

In the opinion of Mexican Restaurants, Inc. (the “Company”), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals and adjustments) necessary for a fair presentation of the consolidated financial position and stockholders’ equity as of April 3, 2011, and the consolidated statements of operations and cash flows for the 13-week periods ended April 3, 2011 and April 4, 2010. The consolidated statements of operations for the 13-week periods ended April 3, 2011 and April 4, 2010 are not necessarily indicative of the results to be expected for the full year or any other interim period. During the interim periods, the Company follows the accounting policies described in the notes to the consolidated financial statements in its “Audited Consolidated Financial Statements and Footnotes” for the year ended January 2, 2011. Reference should be made to such consolidated financial statements for information on such accounting policies and further financial detail.

The Company classifies as discontinued operations for all periods presented any component of the Company’s business that the Company believes is probable of being sold within the next 12 months and that has operations and cash flows that are clearly distinguishable operationally and for financial reporting purposes. For those components, the Company has no significant continuing involvement after disposal, and their operations and cash flows are eliminated from ongoing operations. Sales of significant components of the Company’s business not classified as discontinued operations are reported as a component of income from continuing operations.

2. Income taxes

In determining the provision for income taxes, the Company uses an estimated annual effective tax rate based on forecasted annual income and permanent items, statutory tax rates and tax planning opportunities in the various jurisdictions in which the Company operates. The impact of significant discrete items is separately recognized in the quarter in which they occur.

3. Stock-based compensation

As of April 3, 2011, the Company had one equity-based compensation plan from which stock-based compensation awards can be granted to eligible employees, officers and directors, known as the 2005 Long Term Incentive Plan. A total of 425,000 shares have been authorized for issuance under this plan. The Company’s 1996 Long Term Incentive Plan, its Stock Option Plan for Non-Employee Directors and its 1996 Manager’s Stock Option Plan have each terminated in accordance with its terms, but there are still options which remain exercisable under these plans until the earlier of ten years from the date of grant or no more than 90 days after the optionee ceases to be an employee of the Company. These Company plans are described in more detail in Notes 3 of the “Audited Consolidated Financial Statements and Footnotes” for the fiscal year ended January 2, 2011.

The Company receives a tax deduction for certain stock option exercises during the period in which the options are exercised. These deductions are generally for the excess of the price for which the options were sold over the exercise prices of the options. No stock options were exercised during the 13-week periods ended April 3, 2011 and April 4, 2010.

4. Long term debt

The Company entered into a Credit Agreement with Wells Fargo Bank, N.A. (“Wells Fargo”) in June 2007 (as amended, the “Wells Fargo Agreement”). The Company was in compliance with all debt covenants of the Wells Fargo Agreement as of April 3, 2011.

The Company entered into a forbearance agreement with Wells Fargo on December 9, 2010. The forbearance agreement was effective from November 17, 2010 through January 31, 2011.

Concurrent with the forbearance agreement, the Wells Fargo Agreement was amended primarily to reduce the revolver availability to \$5.5 million effective November 17, 2010. On January 20, 2011, the forbearance agreement was amended to extend the forbearance period until February 15, 2011.

Subsequently, the Wells Fargo Agreement was amended on April 8, 2011. Under this amendment, Wells Fargo agreed to waive the third and fourth quarter 2010 defaults subject to amended terms and conditions to the Credit Agreement. The amended terms and conditions primarily include the following changes to the Credit Agreement: (1) the loan maturity date was extended to June 29, 2013, (2) the maximum available credit was reduced to \$4,725,000 and will continue to be reduced by \$275,000 on the first day of each fiscal quarter beginning July 4, 2011, (3) the rate for borrowing was increased, (4) the calculation of certain financial ratios was redefined and a new financial ratio was added, (5) the measurement periods and certain financial ratio limits were redefined and, (6) a \$1,000,000 capital contribution was required.

At management's option, the revolving loan bears an interest rate equal to the Wells Fargo Base Rate plus a stipulated percentage or LIBOR plus a stipulated percentage. Accordingly, the Company is impacted by changes in the Base Rate and LIBOR. The Company is subject to a non-use fee of 0.50% on the unused portion of the revolver from the date of the Wells Fargo Agreement.

5. Related party transactions

The Company's Vice Chairman of the Board of Directors owns a Casa Olé franchise restaurant for which the Company receives royalties. For the 13-week periods ended April 3, 2011 and April 4, 2010, the Company recognized royalty income of \$5,633 and \$5,582, respectively, related to this restaurant.

On March 31, 2010, the Company sold 113,458 shares of common stock from its treasury shares to Michael D. Domec, a director of the Company and the largest shareholder, for \$277,972 or \$2.45 per share. The per share price was based upon a weighted average based on the preceding 30 days, and the transaction was exempt from registration under Section 4(2) of the Securities Act of 1933. The Company used the proceeds to pay on its line of credit under the Wells Fargo Agreement.

6. Discontinued operations and leasing exit activities

The results of operations, assets and liabilities for all units that have been disposed of, either individually or in the aggregate, are reclassified to discontinued operations and to liabilities associated with leasing and exit activities in the consolidated statements of operations and balance sheets for all periods presented.

As of April 3, 2011, assets related to discontinued operations of \$100,000 consisted of rent receivable from a subleased restaurant. Other assets related to discontinued operations of \$33,878 consisted of security deposits for leases in the state of Michigan that were assigned to a third party in 2009 and which expire in 2019.

Current and long-term liabilities related to leasing and exit activities consisted primarily of accrued closure costs related to two non-interest bearing notes payable made in 2011 to exit two leases (see details below) and of rent differential for two other closed restaurants for which the Company has subleased the restaurants. Rent differential represents the difference between the Company's future contractual lease payment obligations for closed restaurants and contractual future rent payments to be received in accordance with the terms of the subleases.

On February 22, 2011, the Company entered into a "Promissory Note" along with a "Settlement and Release Agreement" to exit the lease related to a store that was closed in November 2010. This \$150,000 non-interest bearing promissory note is included in liabilities associated with leasing and exit activities. A down payment of \$40,000 was made on February 22, 2011 and the

remaining balance of \$110,000 is payable in twelve equal monthly installments beginning March 1, 2011.

On May 2, 2011, the Company entered into a “Promissory Note” along with a “Compromise Settlement and Release Agreement” to exit the lease related to a store that had been subleased. This \$200,000 non-interest bearing promissory note is included in liabilities associated with leasing and exit activities. The principal balance is due in thirty-six equal monthly installments beginning April 1, 2011 and contains a penalty clause that increases the principal to \$600,000, if the Company defaults on the note.

During the first quarter of fiscal year 2010, the Company recognized \$181,543 of restaurant closure costs related to a subleased store that the Company has entered into negotiations with to exit the sublease.

7. Subsequent Events

The Company evaluates subsequent events that have occurred after the balance sheet date but before the financial statements are available for issuance for either recognition or disclosure. The Company evaluated its financial statements for subsequent events through June 24, 2011, the date the financial statements were available for issuance.

On April 11, 2011, the Company received \$1,000,000 in cash in exchange for 800,000 Series A Convertible Preferred Stock shares and non-transferable share warrants to purchase up to 125,000 common stock shares. The equity contribution was made pursuant to resolutions adopted by the Board of Directors on February 4, 2011. The Series A Convertible Preferred Stock has a par value of \$.01 per share and a stated value of \$1.25 per share and may be converted to Common Stock on a one-for-one basis. Dividends accrue at 8% per annum on the preferred stock with payment dates occurring on or before May 15, 2013 to be paid by issuing additional shares of Series A Convertible Preferred stock in lieu of cash. The holders of the Series A Convertible Preferred stock have voting rights provided by the Texas Business Organization Code as well as additional rights as defined in the designating resolutions. The non-transferable share warrants have an exercise price of \$2.00 per share.

On April 18, 2011, the Company paid \$800,000 on its Wells Fargo line of credit. Cash proceeds from the issuance of the Series A Convertible Preferred Stock (discussed in the paragraph above) was used to make the principal debt payment. As of April 18, 2011, the Company’s outstanding debt to Wells Fargo Bank was \$3.6 million.

On May 2, 2011, the Company entered into a “Promissory Note” along with a “Compromise Settlement and Release Agreement” to exit the lease related to a store that had been subleased. This \$200,000 non-interest bearing promissory note is included in liabilities associated with leasing and exit activities. The principal balance is due in thirty-six equal monthly installments and contains a penalty clause that increases the principal to \$600,000, if the Company defaults on the note.